

Fixed Income >>> Public Finance (US)

California Rating Lowered to 'A'

Analyst:

David G Hitchcock, New York (1) 212-438-2022; Alexander M Fraser,
Dallas (1) 214-871-1406

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NEW YORK (Standard & Poor's) Dec. 19, 2002--Standard & Poor's Ratings Services today lowered its ratings on California's \$23.5 billion of GO bonds (excluding bonds also secured by veteran's housing revenues) to 'A' from 'A+', the state's \$12.5 billion of revenue anticipation notes to 'SP-2' from 'SP-1', the state's commercial paper program to 'A-2' from 'A-1', and the state's \$6.4 billion of general fund lease-backed debt, issued by the California State Public Works Department, to 'A-' from 'A'. The outlook is stable.

The downgrades follow Gov. Gray Davis' announcement yesterday of a projected general fund budget gap of \$34 billion for fiscal 2004, absent corrective budget action. In particular, Standard & Poor's conversation with the state budget office indicates a sharply higher general fund deficit of about \$10.4 billion for fiscal 2003, absent proposed corrective budget action, included in the \$34 billion total. This level of deficit will likely exceed the state's level of other borrowable funds at year end, estimated earlier by the state at \$6.4 billion, even if the governor's recently proposed \$3.4 billion midyear fiscal 2003 cuts were implemented.

The state attributes \$17.7 billion of the gap to revenues running below expected levels through fiscal 2004, \$4.5 billion to expenditure increases and nonreceipt of budgeted federal funds, and \$12.6 billion to onetime revenue items used in fiscal 2003 but unable to be repeated in fiscal 2004, including a \$4.5 billion tobacco securitization sale expected in a few months. The new budget gap represents a sharp increase from a \$21 billion comparative total gap the state legislative analyst projected only last month. The increased gap poses an enormous test for the state compared to the size of its annual budget. Fiscal 2003 general fund revenues were budgeted about \$79 billion in fiscal 2003.

The impact of possible state cuts on aid to local governments and school districts will be reviewed when more detail on potential cuts becomes available. The governor's recently proposed \$10.2 billion of midyear corrective budget action, only \$3.4 million of which is attributable to fiscal 2003, can only represent a partial solution to the state's long-term structural budget problems.